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**TO:** Commission on Higher Education Funding  
**FROM:** James H. Douglas, State Treasurer  
**RE:** Annual Report on the Higher Education Trust Fund  
**DATE:** September 5, 2001

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I am pleased to present the State Treasurer's second annual report on the Higher Education Trust Fund. This fund was established in the Office of the State Treasurer by Act No. 27 of the General Assembly in 1999 and was initially funded with an appropriation of \$6 million. The Act was amended in 2001 and provides that in August of each year, the State Treasurer shall withdraw 5% of up to a 12-quarter moving average of the fund's assets and divide the amount equally among the University of Vermont, the Vermont State Colleges, and the Vermont Student Assistance Corporation.

During fiscal year 2001, the Higher Education Trust Fund earned a total return of 10.99%. This compares most favorably with the Standard & Poor's 500 Index, which had a (13.56%) return for the same period. The 5% distribution available this year will be \$321,309.37 in total, or \$107,103.12, each for UVM, VSC and VSAC. In August 2000, each beneficiary received \$106,284.91. (See Appendix A for quarterly market values and distributions for fiscal year 2001.)

Act No. 27 further provides that in August of each year, the Commission on Higher Education Funding may authorize the State Treasurer to make an additional amount equal to up to 2% of the fund's assets available to UVM and the Vermont State Colleges for the purpose of creating or increasing a permanent endowment fund. The amount appropriated, however, cannot exceed an amount that would bring the fund balance below the \$6 million initial appropriation plus any additional contributions to principal.

At its meeting last year, the Commission authorized this 2% appropriation in the amount of \$58,239.80, or \$29,119.90 each, for distribution to the University of Vermont and the Vermont State Colleges dependent upon a finding by the Commission that the terms of this appropriation have been met. Each institution was given until the end of fiscal year 2001 to match the appropriation by raising twice that amount, or \$58,239.80, and to certify to the Commission that it received private donations in the requisite amount and that the funds will be used to create or increase a permanent endowment at the respective institution. Once the Commission finds that the terms have been met at its September meeting, the State Treasurer will distribute the 2% appropriation to UVM and VSC.

This year the fund exceeded its income target and the full 2%, or \$128,523.75, will be available for additional distribution in June 2002 if the committee so authorizes. Each institution's share will be \$64,261.87 with a required match to be raised by each in fiscal year 2002 of \$128,523.75. I note that because of an amendment to 16 V.S.A. §2885(c), effective July 1, 2001, UVM and VSC are required to make the required certifications about this match to the Commissioner of Finance and Management next year, instead of to the Commission on Higher Education Funding.

With regard to the 2% distributions and the required match, I would like to take this opportunity to suggest that the Commission clarify the purpose of the permanent endowment created or increased with this money, as well as the process required to qualify for the matching funds. The statute is clear that the 5% distribution must be used for "nonloan financial aid" to Vermont students. The statute is not explicit about the purpose of the permanent endowments funded with the 2% distribution and the private donations that constitute the matching funds, or about the process required to certify the matching funds. Consequently, there has been some confusion surrounding these issues. My assumption was that the legislature intended the 2% money and the donations required for a match would be used initially to create a permanent endowment and then increase that endowment through subsequent annual distributions. It seems to be unclear whether it is necessary for the institutions to raise the private donations for this explicit fund, or if they can make use of other restricted or unrestricted donations. In addition, it was my understanding that these endowments were to be used for additional nonloan financial aid to Vermont students. Perhaps the legislative members on the Commission who served when this legislation passed can shed some light on the legislature's intent and on the nature of the private donations required.

I am extremely pleased that this fund had such an outstanding performance in its first year. After the payments of \$321,365.53 and \$58,239.80, the balance in the fund at the beginning of fiscal year 2002 was \$6,299,900.20 plus the additional \$1 million appropriated by the Legislature, which was added to the fund on July 1, for a total balance of \$7,299,900.20.

An accounting of the fund balances is provided below:

Balance June 30, 1999	\$6,377,094.53
Distribution August 15, 2000	(318,854.73)
Income earned fiscal year 2001	358,744.76
Appreciation (Depreciation)	276,772.39
Fees and Other Charges	<u>(15,133.53)</u>
Balance June 30, 2001	\$6,679,449.37
5% of Five Quarter Moving Average: June 30, 2001	\$321,309.37
Distributions: University of Vermont	\$107,103.12
Vermont State Colleges	107,103.12
Vermont Student Assistance Corporation	107,103.12
2% Income Available for Endowments 2000	\$58,239.80
Balance June 30, 2001	\$6,299,900.20
Addition to Principal	\$1,000,000.00
Total Fund July 1, 2001	\$7,299,900.20
2% Income Available for Endowments 2002	\$128,523.75

The Legislature appropriated another \$1 million for the Higher Education Trust Fund during the past legislative session, increasing its balance to \$7,299,900. In addition, nearly \$4 million in additional funding was appropriated for the Tobacco Trust Fund. These additions gave me the opportunity to increase the equity allocation to 20% of the total fund, from its initial 10% last year. Even though the 90% allocation to fixed income served us extremely well for fiscal year 2001, the additional allocation to equities is imperative for the fund to stay ahead of inflation over the longer term.

I have attached a spreadsheet as Appendix B that shows the total return of the entire Investment Trust Account, of which the Higher Education Trust Fund at \$7,299,900 comprises approximately 24%. The Tobacco Trust Fund comprises 75% of the account, or \$23,323,708, and the remaining 1% is made up of eight small unexpendable trusts that total \$434,437.

Please feel free to contact me if you have any questions or would like to discuss this further.

cc: Sean Campbell, Commissioner of Finance & Management  
Anne Winchester, Legislative Council

## APPENDIX A

### QUARTERLY MARKET VALUES

	Balance 6/30/2000	Balance 9/30/2000	Balance 12/31/2000	Balance 3/31/2001	Balance 6/30/2001	Five Quarter Average
<b>Education Trust</b>	<b>\$6,377,094.53</b>	<b>\$6,151,054.75</b>	<b>\$6,355,860.72</b>	<b>\$6,567,477.88</b>	<b>\$6,679,449.36</b>	<b>\$6,426,187.45</b>

### DISTRIBUTIONS

<b>5% Distribution</b>	<b>\$321,309.37</b>	
VSAC		\$107,103.12
UVM		\$107,103.12
VSC		\$107,103.12
 <b>2% FY2000</b>	 <b>\$58,239.80</b>	
UVM		\$29,119.90
VSC		\$29,119.90
 <b>Balance after Distributions</b>	 <b>\$6,299,900.19</b>	
 <b>Additions to Principal</b>	 <b>\$1,000,000.00</b>	
 <b>Balance beginning FY2002</b>	 <b>\$7,299,900.19</b>	
 2% Available for FY2002	 \$128,523.75	

## APPENDIX B

<b>MANAGER</b>	Quarter ended 9/30/2000	Quarter ended 12/31/2000	Quarter ended 3/31/2001	Quarter ended 6/30/2001	<b>Fiscal Year 2001*</b>	<b>Calendar Year to Date</b>	Portfolio Market 6/30/2001	Portfolio Percent 6/30/2001
<b>DOMESTIC EQUITY</b>								
Hanson Investment Management	(1.40)	8.70	3.50	15.40	28.01	19.10	\$1,626,373	6.1%
Prentiss Smith & Co.	1.14	3.08	1.98	0.91	7.29	2.91	\$1,352,652	5.1%
S&P 500	0.60	(7.82)	(11.86)	5.80	(13.56)	(6.75)		
<b>DOMESTIC FIXED INCOME</b>								
NL Capital Management	2.32	3.18	3.32	0.94	10.13	4.29	\$23,541,523	88.8%
Lehman Aggregate	2.09	4.21	3.04	0.56	10.24	3.61		
<b>TOTAL FUND RETURN</b>								
	2.06	3.47	3.26	1.82	10.99	5.12		
Total Fund Target	1.93	2.93	1.46	1.08	7.86	2.58		
<b>TOTAL FUND MARKET VALUE</b>								
	\$24.3	\$25.3	\$26.1	\$26.5	\$26.5		\$26,520,548	100.0%

\* Inception date 7/15/00